No. 12259

In The United States Court of Appeals
For the Ninth Circuit

SEATTLE HARDWARE COMPANY, *Appellant,*

vs.

CLARK SQUIRE, Collector of Internal Revenue, *Appellee,*

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

REPLY BRIEF FOR APPELLANT

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INTRODUCTORY

At pages 16 and 17 of his brief, appellee makes the following concession:

> "It may be assumed for the sake of argument that in determining the correct invested capital credits for the several taxable years involved, the taxpayer is entitled to include the property in question as 'property * * * previously paid in,' under the provisions of Section 718 (a) (2); and, further, that in ascertaining the correct amount of the loss on the sale of the property in 1945, the cost basis thereof must be the aggregate of the amounts actually paid by the taxpayer for the two lots in 1901 and for the construction of the building thereon in 1904-1905, as the District Court found, or the fair market value of the property on February 21, 1906, when the subsidiary's assets were allegedly, upon its liquidation,

distributed to the taxpayer, as the taxpayer contends."

That narrows the issues down to the points raised in his argument as follows:

1. "The separate identity of Occident should be ignored because it was merely an instrumentality of the taxpayer's business under the complete domination and control of the taxpayer without any real business purpose or activity other than to hold record title to the property for the taxpayer's use and benefit."

2. "Even though Occident might have been a complete corporate organization under local law, nevertheless state laws covering transactions valid thereunder are not controlling under the federal laws for federal tax purposes, as here."

3. "Moreover, since there was never any liquidation or dissolution of Occident, the taxpayer's claim that it is entitled to cost bases equal to the value of Occident's stock purportedly exchanged for the property in question upon liquidation of the subsidiary in 1906, is without support in the record."

ARGUMENT

The issue presented in point one above has been fully covered by appellant's opening brief.

The issue presented in point three above has been fully covered by appellant's opening brief. At pages 38 to 41, appellant cited a number of decisions to the effect that where a parent takes all of the assets out of a subsidiary that is a liquidation of the subsidiary even though it is not immediately followed by formal dissolution. Appellee cites no authorities at all on this point.

Under point two, appellee refers to that portion of appellant's brief which establishes that Occident's organization was complete under local law, and then states that the issue is determinable by federal rather than state law. Appellee cites a number of decisions all on the general point that the legal significance of a transaction under state law is not necessarily controlling in federal tax matters.

First of all it should be noted that appellee cites no authorities to the effect that the organization of Occident would be incomplete under federal law. Secondly, appellee cites no authorities to the effect that the completeness or incompleteness of the organization of Occident is controlled by federal rather than state law.

Appellant assumed the question of the completeness of the organization of Occident was controlled by state law since it was state law that gave Occident its corporate life. The authorities agree.

Section 61.09 of Mertens' Law of Federal Income Taxation, Volume 10A, pages 266-269, states the general rule of when state or federal law applies as follows:

> "While the federal courts have generally sought to respect the decisions of the state courts regarding rules of property in the interpretation of the income tax law, this has not been possible in every instance and a conflict has frequently resulted. The Supreme Court has attempted to resolve the conflict by establishing two rules, as follows:
>
> "(1) Where the question is the meaning of a federal statute, such as the revenue act, the will of Congress controls, and the federal statute is to be interpreted so as to give a 'uniform application to a nation-wide scheme of taxation' so that taxation may not be escaped through local decisions.
>
> "(2) When the will of Congress depends upon a fact which can be interpreted only according to a state rule of property, as upon the question whether title has passed under state law, the state rule will govern."

Section 61.15 (Volume 10A, page 287) states in part: part:

> "Corporations, as creatures of local law, are governed thereby in all respects not conflicting with specific income tax provisions."

The question of whether Occident's organization was complete or not is really a question of whether or not the corporate life had commenced. Basically, that question involves the same application of state or federal law as the question of whether or not the cor-

porate life has terminated. In the latter situation the courts have uniformly held that state law and not federal law controls. The Ninth Circuit in the case of *G. M. Standifer Construction Corporation v. Commissioner*, 78 F.(2d) 285, so determined when they cited with approval the following language of the Supreme Court of the United States in *Oklahoma Natural Gas Co. v. State of Oklahoma*, 273 U.S. 257, 259, 47 S. Ct. 391, 392, 71 L. ed. 634:

> "But corporations exist for specific purposes, and only by legislative act, so that if the life of the corporation is to continue even only for litigating purposes it is necessary that there should be some statutory authority for the prolongation. The matter is really not procedural or controlled by the rules of the court in which the litigation pends. It concerns the fundamental law of the corporation enacted by the state which brought the corporation into being."

CONCLUSION

Taxpayer should prevail in this case.

Respectfully submitted,

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